

CENTRAL WATER SYSTEM
INDEPENDENT AUDITOR'S REPORTS
FINANCIAL STATEMENTS AND FINDINGS
DECEMBER 31, 2005

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CENTRAL WATER SYSTEM

December 31, 2005

OFFICIALS

NAME	TITLE
Jake Hinshaw	Director – Chairman
Del Leiss	Director
Larry Stoller	Director
Michael Miller	Plant Superintendent

DAVID A. MASKE

Certified Public Accountant

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Central Water System
Okoboji, Iowa

I have audited the accompanying financial statements, listed as exhibits in the table of contents of this report of Central Water System as of December 31, 2005 and 2004, and for the years then ended. These financial statements are the responsibility of the Systems management. My responsibility is to express an opinion on these financial statements based on my audit.

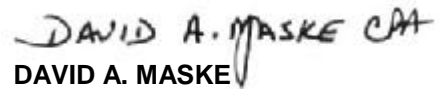
I conducted the audit in accordance with U.S. generally accepted auditing standards, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that the audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to in the first paragraph present fairly in all material respects the financial position of Central Water System at December 31, 2005 and 2004, and the results of operations and changes in cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, I have also issued my reports dated May 24, 2006, on my consideration of the Central Water System's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report when considering the results of my audit.

Management's Discussion and Analysis and budgetary comparison information on pages 3 through 4 and pages 14 through 15 are not required parts of the basic financial statements, but are supplementary information required by the Government Accounting Standards Board. I applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. I did not audit the information and express no opinion on it.

My audit was performed for the purpose of forming an opinion of the financial statements taken as a whole. I previously audited the financial statements for the two years ended December 31, 2003 (none of which are presented here-in) and expressed an unqualified opinion on those financial statements.


DAVID A. MASKE
Certified Public Accountant

May 24, 2006
Spencer, Iowa

CENTRAL WATER SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2005

Central Water System provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended December 31, 2005. We encourage readers to consider this information in conjunction with the System's financial statements, which follow.

2005 FINANCIAL HIGHLIGHTS

- Operating revenue of the System increased 2.1%, or approximately \$6,000 from fiscal 2004 to fiscal 2005.
- Operating expenses decreased 0.2%, or approximately \$600 in fiscal 2005 from fiscal 2004.
- The System's total net assets decreased 2.9%, or approximately \$66,600 from December 31, 2004 to December 31, 2005. Total liabilities decreased 3.0% or approximately \$35,800.

USING THIS ANNUAL REPORT

The annual report consists of a series of financial statements and other information as follows:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the System's financial activities.

The System's basic financial statements consist of balance sheets, statements of revenue, expenses, changes in retained earnings and statements of cash flows. The statements provide information about the activities of the System as a whole and present an overall view of the System's finances.

Notes to financial statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

Required Supplementary Information further explains and supports the financial statements with a comparison of the System's budget for the year.

Basis of Accounting

The System maintains its financial records on accrual basis and the financial statements of the System are prepared on that basis.

REPORTING THE SYSTEM'S FINANCIAL ACTIVITIES

One of the most important questions asked about the System's finances is, "Is the System as a whole better off or worse off as a result of the year's activities?" The Balance Sheet reports information which helps answer this question.

The Balance Sheet presents the System's net assets. Over time, increases or decreases in the System's net assets may serve as a useful indicator of whether the financial position of the System is improving or deteriorating.

SYSTEM-WIDE FINANCIAL ANALYSIS

A summary of the changes in the retained earnings follows:

	YEAR ENDED DECEMBER 31,	
	<u>2005</u>	<u>2004</u>
REVENUE:		
Water Income	\$ 290,944	\$ 284,898
Other Income	18,045	12,000
Interest	<u>10,760</u>	<u>6,345</u>
TOTAL REVENUE	<u>\$ 319,749</u>	<u>\$ 303,243</u>
EXPENSES:		
Operating Expenses	\$ 283,537	\$ 282,462
Interest	<u>66,953</u>	<u>68,669</u>
TOTAL EXPENSES	<u>\$ 350,490</u>	<u>\$ 351,131</u>
NET (LOSS)	\$ (30,741)	\$ (47,888)
RETAINED EARNINGS – BEGINNING OF YEAR	<u>20,061</u>	<u>67,949</u>
RETAINED EARNINGS (DEFICIT) – END OF YEAR	<u>\$ (10,680)</u>	<u>\$ 20,061</u>

BUDGETARY HIGHLIGHTS

Over the course of the year, the System did not exceed its budget.

DEBT ADMINISTRATION

At December 31, 2005, the System had \$1,155,000 in bonds outstanding, compared to \$1,190,000 last year.

The System redeemed \$35,000 in debt during the year.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives.

BASIC FINANCIAL STATEMENTS

CENTRAL WATER SYSTEM
BALANCE SHEETS
DECEMBER 31,

	<u>2005</u>	<u>2004</u>
ASSETS		
CURRENT ASSETS:		
Cash on Hand and in Bank	\$ 37,245	\$ 41,176
Cash in Savings and Certificates	132,340	136,307
Accounts Receivable	16,523	22,211
Prepaid Expenses	14,463	14,068
Accrued Interest Receivable	1,435	922
TOTAL CURRENT ASSETS	<u>\$ 202,006</u>	<u>\$ 214,684</u>
FIXED ASSETS (NOTE 2):		
Fixed Assets	\$ 3,079,442	\$ 3,066,247
Accumulated Depreciation	(1,306,121)	(1,228,340)
TOTAL FIXED ASSETS	<u>\$ 1,773,321</u>	<u>\$ 1,837,907</u>
OTHER ASSETS:		
Loan Costs (Net)	\$ 28,630	\$ 30,266
RESTRICTED ASSETS:		
Bond Sinking Fund	\$ 8,779	\$ 8,508
Bond Improvement Fund	90,000	78,000
Bond Reserve Fund	106,400	106,400
TOTAL RESTRICTED ASSETS	<u>\$ 205,179</u>	<u>\$ 192,908</u>
TOTAL ASSETS	<u>\$ 2,209,136</u>	<u>\$ 2,275,765</u>
LIABILITIES AND FUND EQUITIES		
CURRENT LIABILITIES:		
Accounts Payable	\$ 6,244	\$ 7,021
Accrued Interest	5,446	5,591
Accrued Payroll Taxes	2,926	2,892
Current Portion Long-Term Debt	40,000	35,000
TOTAL CURRENT LIABILITIES	<u>\$ 54,616</u>	<u>\$ 50,504</u>
LONG-TERM DEBT (NOTE 3):		
Revenue Bonds Payable	\$ 1,155,000	\$ 1,190,000
LESS – Current Portion Above	40,000	35,000
TOTAL LONG-TERM DEBT	<u>\$ 1,115,000</u>	<u>\$ 1,155,000</u>
TOTAL LIABILITIES	<u>\$ 1,169,616</u>	<u>\$ 1,205,504</u>
FUND EQUITY:		
CONTRIBUTED CAPITAL		
Restricted	\$ 205,179	\$ 192,908
Unrestricted	845,021	857,292
TOTAL	<u>\$ 1,050,200</u>	<u>\$ 1,050,200</u>
RETAINED EARNINGS:		
Unrestricted (Deficit)	\$ (10,680)	\$ 20,061
TOTAL FUND EQUITY	<u>\$ 1,039,520</u>	<u>\$ 1,070,261</u>
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 2,209,136</u>	<u>\$ 2,275,765</u>

See accompanying Notes to Financial Statements

CENTRAL WATER SYSTEM
STATEMENTS OF REVENUES AND EXPENSES
FOR THE YEARS ENDED DECEMBER 31,

	<u>2005</u>	<u>2004</u>
REVENUE:		
Operating Income	\$ 290,944	\$ 284,898
OPERATING EXPENSES:		
Salaries - Superintendent	\$ 39,846	\$ 38,646
Salaries - Other	33,055	31,855
Chemicals	30,868	25,957
Repairs	6,770	19,722
Utilities	37,955	33,412
Payroll Taxes	9,810	9,407
Employee Insurance	18,290	17,826
General Insurance	12,040	12,020
Lab Supplies	2,886	1,141
Testing and Lab Fees	4,578	2,718
Vehicle Expenses	938	3,906
Clothing Allowance	793	777
Legal and Professional	1,981	1,650
Water Study	-0-	456
Office Supplies and Postage	1,942	1,194
Telephone	683	628
Board Expense	725	775
Bond Expense	800	700
Continuing Education	160	140
Amortization	1,636	1,636
Depreciation	77,781	77,896
TOTAL OPERATING EXPENSES	<u>\$ 283,537</u>	<u>\$ 282,462</u>
OPERATING INCOME	\$ 7,407	\$ 2,436
NON-OPERATING INCOME (EXPENSE):		
Interest Income	\$ 10,760	\$ 6,345
Other Income	18,045	12,000
Interest Expense	(66,953)	(68,669)
TOTAL NON-OPERATING INCOME (EXPENSE)	<u>\$ (38,148)</u>	<u>\$ (50,324)</u>
NET INCOME (LOSS)	<u>\$ (30,741)</u>	<u>\$ (47,888)</u>

See accompanying Notes to Financial Statements

CENTRAL WATER SYSTEM
STATEMENTS OF CHANGES IN RETAINED EARNINGS
FOR THE YEARS ENDED DECEMBER 31,

	<u>2005</u>	<u>2004</u>
RETAINED EARNINGS – January 1	\$ 20,061	\$ 67,949
NET INCOME (LOSS)	<u>(30,741)</u>	<u>(47,888)</u>
RETAINED EARNINGS (DEFICIT) – December 31	<u>\$ (10,680)</u>	<u>\$ 20,061</u>

See accompanying Notes to Financial Statements

CENTRAL WATER SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

	<u>2005</u>	<u>2004</u>
CASH PROVIDED FROM (USED) FOR OPERATIONS:		
Net Income (Loss)	\$ (30,741)	\$ (47,888)
Adjustments for Non-Cash Items:		
Depreciation & Amortization	<u>79,417</u>	<u>79,532</u>
	<u>\$ 48,676</u>	<u>\$ 31,644</u>
ADJUSTMENTS FOR WORKING CAPITAL CHANGES:		
(Increase) Decrease in Accounts Receivable.....	5,688	24,348
(Increase) Decrease in Prepaid Expenses	(395)	(401)
(Increase) Decrease in Accrued Interest Receivable	(513)	169
Increase (Decrease) in Accounts Payable.....	(777)	(2,107)
Increase (Decrease) in Accrued Interest Payable	(145)	(143)
Increase (Decrease) in Accrued Taxes Payable	34	121
CASH PROVIDED BY OPERATIONS	<u>\$ 52,568</u>	<u>\$ 53,631</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Principal Paid on Bonds.....	<u>\$ (35,000)</u>	<u>\$ (35,000)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of Fixed Assets.....	<u>\$ (13,195)</u>	<u>\$ -0-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	<u>\$ 4,373</u>	<u>\$ 18,631</u>
CASH AND CASH EQUIVALENTS – BEGINNING	<u>370,391</u>	<u>351,760</u>
CASH AND CASH EQUIVALENTS – ENDING	<u>\$ 374,764</u>	<u>\$ 370,391</u>
Interest paid for the year	<u>\$ 67,097</u>	<u>\$ 68,812</u>

See accompanying Notes to Financial Statements

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY – Central Water System was organized by a Joint Public Improvement Agreement between the City of Arnolds Park and the City of Okoboji dated April 11, 1977. Central Water System, organized under the Code of Iowa, Chapter 28E (1975), was designed to operate a water system to jointly serve the two municipalities. The Clay County Rural Water District was later added as a customer through a water purchase contract with Central Water System dated January 11, 1989. All facilities and land acquired or constructed in connection with the System are to be owned by the two municipal parties as tenants in common with undivided ownership interest. Each party is responsible for retiring its portion of the debt incurred. Future expansion of the plant shall be paid on a pro rata basis in accordance with water usage.

Central Water System is operated by the parties through a joint Board of Directors consisting of one member from each City Council, or such other individual as that Council shall designate, and a third member appointed and approved by a majority vote of the City Councils of the municipalities.

For financial reporting purposes, Central Water System has included all funds, organizations, account groups, agencies, boards, commissions and authorities. The System has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the System are such that exclusion would cause the System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria included appointing a voting majority of an organization's governing body, and (1) the ability of the System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the System. The Central Water System has no component units which meet the Governmental Accounting Standards Board criteria.

BASIS OF ACCOUNTING – Central Water System maintains its financial records on the accrual basis of accounting and in accordance with U.S. generally accepted accounting principals.

ACCOUNTS RECEIVABLE - Accounts receivable and revenue are recorded at the time that service is billed. Unbilled revenue for service consumed between periodic scheduled billing dates is not considered to have a material effect on the financial statements. Accounts are reviewed annually; accounts considered uncollectable are written off at that time.

CASH AND CASH EQUIVALENTS - For the purposes of the statement of cash flows, the System considers as cash and cash equivalents all currency on hand, demand deposits with banks or other financial institutions, certificates of deposits with an original maturity of six months or less, and other accounts that have the general characteristics of demand deposits in that the System may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty.

OTHER ASSETS - Loan costs are being amortized on a straight-line basis over 25 years, and is presented at its net value.

USE OF ESTIMATES - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

INCOME TAXES – Central Water System is exempt from federal and state income taxes.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2005

NOTE 2 - PROPERTY, PLANT AND EQUIPMENT:

Fixed assets are stated at cost. The report sets forth the original cost of the assets and accumulated depreciation thereon, based on depreciation rates commensurate with the average normal useful life of the various components of the plant and system.

Depreciation rates have been applied on a straight-line basis. Estimated useful lives, in years, for depreciable assets are as follows:

Plant and Distribution System	40
Equipment	5 – 25

A summary of changes in fixed assets is as follows:

Property Plant & Equipment, January 1, 2004	\$ 3,066,247
Additions January 1 – December 31, 2004	-0-
Deletions January 1 – December 31, 2004	-0-
Property Plant & Equipment, December 31, 2004	\$ 3,066,247
Additions January 1 – December 31, 2005	13,195
Deletions January 1 – December 31, 2005	-0-
Property Plant & Equipment, December 31, 2005	<u>\$ 3,079,442</u>

NOTE 3 - LONG-TERM DEBT:

During the year ended December 31, 1998, Central Water System issued \$1,140,000 in Series A Waterworks System Improvement Revenue Bonds for the construction of two elevated water storage tanks and \$210,000 in Series B Waterworks System Improvement Revenue Bonds to pay off its debt from Waterworks System Improvement Revenue Bonds issued April 1, 1996. The bonds and interest are to be paid out of charges for service. The bonds bear interest of 4.50% – 5.75%.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2005

NOTE 3 - LONG-TERM DEBT (CONTINUED):

Details of Central Water System's bonded indebtedness for the years ending December 31 are as follows:

Year	<u>Principal</u>		<u>Interest</u>	<u>Total</u>
	<u>Series A</u>	<u>Series B</u>		
2006	\$ 25,000	\$ 15,000	\$ 65,347	\$ 105,347
2007	40,000	-0-	63,306	103,306
2008	45,000	-0-	61,227	106,227
2009	45,000	-0-	58,865	103,865
2010	45,000	-0-	56,480	101,480
2011	50,000	-0-	54,050	104,050
2012	55,000	-0-	51,175	106,175
2013	55,000	-0-	48,012	103,012
2014	60,000	-0-	44,850	104,850
2015	65,000	-0-	41,400	106,400
2016	65,000	-0-	37,662	102,662
2017	70,000	-0-	33,925	103,925
2018	75,000	-0-	29,900	104,900
2019	80,000	-0-	25,587	105,587
2020	85,000	-0-	20,987	105,987
2021	85,000	-0-	16,100	101,100
2022	95,000	-0-	11,212	106,212
2023	100,000	-0-	5,750	105,750
Total	<u>\$ 1,140,000</u>	<u>\$ 15,000</u>	<u>\$ 725,835</u>	<u>\$ 1,880,835</u>

The resolution providing for the issuance of the revenue bonds provides for the creation of the following restricted asset accounts:

a) SINKING ACCOUNT – Money in the Revenue Account shall be disbursed to make deposits into a separate and special Account to pay principal of and interest on the Bond and Parity Bonds. The Account shall be known as the Water Revenue Bond and Interest Sinking Account (the "Sinking Fund"). The required amount to be deposited in the Sinking Fund in any month shall be an amount equal to 1/6th of the installment of interest coming due on the next interest payment date on the then outstanding Bond and Parity Bonds plus 1/12th of the installment of principal coming due on such Bonds on the next succeeding principal payment date until the full amount of such installment is on hand. Money in the Sinking Account shall be used solely for the purpose of paying principal of and interest on the Bonds and Parity Bonds as the same shall become due and payable.

b) WATER REVENUE DEBT SERVICE RESERVE ACCOUNT – Money in the Revenue Account shall be disbursed to an account known as the Water Revenue Debt Service Reserve Account (the "Reserve Account") to maintain a debt service reserve in an amount equal to the lesser of (1) the maximum amount of principal and interest coming due on the Bonds and any parity Bonds in any succeeding fiscal year or (2) 10% of the proceeds of the sale of the Bonds to the public. Whenever required to maintain the amount at such a level, monthly payments will be made into the Reserve Account in an amount equal to 25% of the monthly deposits being made into the Sinking Account, until such time as the sums on deposit in the Reserve Account are equal to the balance required above. Whenever there is on-hand in the Reserve Account an amount equal to the balance required above, no further deposits need be made into said Reserve Account except to maintain such required balance, and if the amount on deposit in the Reserve Account is greater than the balance required above, such additional amounts shall be withdrawn and paid into the Revenue Account. Money in the Debt Service Reserve Account shall be used solely for payment of principal and interest on the Bonds and any parity Bonds when insufficient funds are available in the Sinking Account.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2005

NOTE 3 - LONG-TERM DEBT (CONTINUED):

c) WATER IMPROVEMENT ACCOUNT – Money in the Revenue Account shall next be disbursed to maintain an account known as the Water Improvement Account (the “Improvement Account”). Minimum monthly deposits into the Improvement Account shall be \$ 1,000 until such time as the account has a balance of \$200,000. Moneys on deposit in this account may be issued for deficiencies a) or b) above.

d) SURPLUS REVENUES – All moneys thereafter remaining in the Revenue Account at the close of each month may be deposited in any of the accounts created by this Resolution, to pay for extraordinary repairs or replacements to the System, or may be used to pay or redeem the Bonds or Parity Bonds a of them, or for any lawful purpose.

A summary of changes in Long-Term Debt for the years ended December 31, 2005 and 2004 is as follows:

Water Revenue Bond Issue 1998 – Series A:	
Balance January 1, 2004	\$ 1,140,000
Issued January 1 – December 31, 2004	-0-
Retired January 1 – December 31, 2004	<u>-0-</u>
Balance December 31, 2004	\$ 1,140,000
Issued January 1 – December 31, 2005	-0-
Retired January 1 – December 31, 2005	<u>-0-</u>
Balance December 31, 2005	<u>\$ 1,140,000</u>
Water Revenue Bond Issue 1998 – Series B:	
Balance January 1, 2004	\$ 85,000
Issued January 1 – December 31, 2004	-0-
Retired January 1 – December 31, 2004	<u>35,000</u>
Balance December 31, 2004	\$ 50,000
Issued January 1 – December 31, 2005	-0-
Retired January 1 – December 31, 2005	<u>35,000</u>
Balance December 31, 2005	<u>\$ 15,000</u>

NOTE 4 - PENSION AND RETIREMENT BENEFITS:

The System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual salary and the System is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The System contribution to IPERS for the years ended December 31, 2005, 2004, and 2003 were \$ 4,192, \$ 4,054, and \$ 3,916 respectively, equal to the required contributions for each year.

CENTRAL WATER SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2005

NOTE 5 - DEPOSITS AND INVESTMENTS:

The Systems deposits in banks at December 31, 2005, were entirely covered by Federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Directors; prime eligible bankers acceptances; certain high-rated commercial paper; perfected purchase agreement; certain registered open-end management investment companies; and certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The System had no investments at December 31, 2005 and 2004.

The System had Certificates of Deposit and Savings balances of \$337,519 at December 31, 2005 and \$329,215 at December 31, 2004.

NOTE 6 - COMPENSATED ABSENCES:

Central Water System has established a written policy for sick leave and vacation accrual which states that no sick leave or vacation pay will accumulate one year to the next. Therefore, there are no accrued compensated absences at December 31, 2005 or December 31, 2004.

NOTE 7 - INTEREST EXPENSE:

Interest costs are capitalized when incurred on debt where proceeds were used to finance the construction of assets. Interest earned on proceeds of tax-exempt borrowing arrangements restricted to the acquisition of qualifying assets is offset against interest costs in determining the amount to be capitalized. The System had no capitalized interest during the year.

NOTE 8 - RISK MANAGEMENT

Central Water System is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

REQUIRED SUPPLEMENTAL INFORMATION

CENTRAL WATER SYSTEM
BUDGETARY COMPARISON OF REVENUE, EXPENSES AND
CHANGES IN RETAINED EARNINGS
YEAR ENDED DECEMBER 31, 2005

	ACTUAL	BUDGET	VARIANCE FAVORABLE (UNFAVORABLE)
REVENUE:			
Use of Money and Property	\$ 10,760	\$ 6,500	\$ 4,260
Services	290,944	295,000	(4,056)
Other	<u>18,045</u>	<u>12,000</u>	<u>6,045</u>
TOTAL REVENUE	\$ 319,749	\$ 313,500	\$ 6,249
 EXPENSES	 <u>350,490</u>	 <u>365,408</u>	 <u>14,918</u>
 NET (LOSS)	 \$ (30,741)	 \$ (51,908)	 \$ 21,167
RETAINED EARNINGS – JANUARY 1	<u>20,061</u>	<u>20,061</u>	<u>-0-</u>
 RETAINED EARNINGS (DEFICIT) – DECEMBER 31	 <u><u>\$ (10,680)</u></u>	 <u><u>\$ (31,847)</u></u>	 <u><u>\$ 21,167</u></u>

See accompanying independent auditor's report

CENTRAL WATER SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – BUDGETARY REPORTING
DECEMBER 31, 2005

The budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41.

In accordance with the Code of Iowa, the System annually adopts a budget, following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon classes of disbursements known as functions. The System did not exceed its budget during the year.

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**Independent Auditor's Report on Internal Control over Financial Reporting and
on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance with
Government Auditing Standards**

To the Board of Directors of Central Water System:

I have audited the general purpose financial statements of Central Water System as of and for the year ended December 2005 and 2004, and have issued my report thereon dated May 24, 2006. My report expressed an unqualified opinion on the financial statements which were prepared in conformity with U.S. generally accepted accounting principles. I conducted my audit in accordance with U.S. generally accepted auditing standards, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Central Water System's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect Central Water System's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part I of the accompanying Schedule of Findings.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, I believe Item 05-I-A is a material weakness. Prior year reportable conditions have been resolved except for Item 05-I-A.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Central Water System's general purpose financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Comments involving statutory and other legal matters about the Central Water System's operations for the years ended December 31, 2005 and 2004 are based exclusively on knowledge obtained from procedures performed during my audit of the general purpose financial statements of the Central Water System. Since my audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited.

This report, a public record by law, is intended solely for the information and use of the officials and employees of the Central Water System and other parties to whom Central Water System may report. This report is not intended to be and should not be used by anyone other than these specified parties.

I would like to acknowledge the many courtesies and assistance extended to me by personnel of Central Water System during the course of my audit.

Should you have any questions concerning any of the above matters, I shall be pleased to discuss them with you at your convenience.


DAVID A. MASKE
Certified Public Accountant

CENTRAL WATER SYSTEM
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2005

PART I: FINDINGS RELATED TO THE GENERAL PURPOSE FINANCIAL STATEMENTS

INSTANCES OF NON-COMPLIANCE:

No matters were reported.

REPORTABLE CONDITIONS:

05-I-A Segregation of Duties - During my review of the internal control structure, the existing procedures are evaluated in order to determine that incompatible duties, from a control standpoint, are not performed by the same employee. This segregation of duties helps to prevent losses from employee error or dishonesty and therefore maximizes the accuracy of the System's financial statements. I noted that one individual is primarily responsible for all record-keeping and reconciling functions for the office.

Recommendation - I realize that with a limited number of office employees, segregation of duties is difficult. However, the System should review the operating procedures of the office to obtain the maximum internal control possible under the circumstances, with continued administrative review by Directors.

Response and Corrective Action Planned - We continually review our operating procedures and strive to improve the internal control and segregation of duties whenever possible. Administrative and Board review of transactions and financial information is an important part of the controls in place, and is relied upon to strengthen controls.

Conclusion - Response accepted.